

MISSOURI DEPARTMENT OF ECONOMIC DEVELOPMENT

DIVISION OF CREDIT UNIONS

NEWSLETTER

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WHAT'S NEW

The "What's New" section on the Division of Credit Unions' web site publishes hot topics of current interest or repeated findings in credit unions being examined. We welcome your suggestions on topics of interest or information that should be addressed. Similarly, we invite questions, suggestions or comments on the topics we write about. We can receive them by e-mail addressed to cu@ded.state.mo.us, calling the Division of Credit Unions at (573) 751-3419 or contacting your assigned examiner.

CREDIT UNION LEADERSHIP

NOW is the time to recruit candidates for your next annual meeting. Many credit unions complain that they can't find volunteers to fill vacancies on the board of directors or committees. Some credit unions are even forced to merge due to a lack of volunteer leaders. Take action to avoid these situations.

Nominating Committee – Maintain a standing nominating committee. Rather than waiting until time for your annual meeting, appoint the nominating committee now. This committee should be active in seeking volunteers on an on-going basis.

Recruit on the Web – If you are looking for new volunteers, try the internet. Place an advertisement on your web site asking for volunteers. This may be a group of individuals that no one has previously asked to serve in a volunteer capacity.

Term Limits – Consider term limits for volunteer positions. This forces a change in individuals, requires officials and operating staff to constantly search for volunteers, and provides an atmosphere that encourages member participation.

Encourage your members to display ownership through leadership.

Interest Rate Risk

Eliminating interest rate risk is not the goal. However, managing the risk is essential to a sound operation. **When**, NOT **IF**, interest rates will rise is the question. No one is sure of the answer. However, if you have a strong

asset/liability management program and are managing interest rate risk, the 'when' is not important.

Take a few steps now to mitigate your risk:

1. Determine your board of directors' risk tolerance. Everyone has a certain tolerance for risk. The board of directors needs to identify its tolerance and provide operating management direction for working within these limits. The board's tolerance can often be stated in the amount of net worth the board is willing to lose. Quantifying this level can be done by adopting a minimum capital level after 'shocking' the balance sheet.
2. Analyze your position
Management must determine the current position. Rather than simply grouping all government securities or all real estate loans together, a sound analysis reviews the characteristics of each category. Review maturity, caps, floors, adjustment periods, call dates, and other identifying characteristics of each sub-category of investments and loans.
3. Study the options
Once the current position is reviewed, the balance sheet should be 'shocked' to determine the potential effect of interest rate movement. If the results are not within the board's determined risk tolerance, management should determine a course of action to bring the balance sheet into line with the board's comfort level. Periodic review and continual restructuring of investments or loans will permit a gradual change in assets. This is much preferable to a sudden, more drastic shift that could have detrimental results.

The 10 year treasury note moved upward 146 basis points between June 13 and August 13, 2003. This move in interest rates caused the price of a 5% mortgage backed security to fall from a premium of nearly 103 to a below-par price of 95. Additional increases in interest rates will continue to affect the value of your assets. Be prepared for such changes by appropriately managing your interest rate risk.

Call Report Process

All Missouri credit unions over \$10 million in assets now prepare an NCUA 5300 call report on a quarterly basis. Every Missouri credit union submits call reports at least semi-annually. Data from these reports is used by credit union management, other credit union officials and staff, regulatory agencies, share insurers, and legislators. Consequently, it is essential that these reports be accurate.

Management should consider several items in processing the call report:

- Completion of the 5300 can be simplified by designing the credit union's financial statement to coincide with the categories on the call report. This should save time and reduce the burden of preparation.
- Review of changes to the call report will aid in ensuring accuracy of the information. Revisions to the call report are always included in the instruction booklet, generally on the first page. Please note any changes prior to preparing the 5300.
- Maintaining supporting documentation will simplify review by credit union staff or by outside parties such as regulators and auditors. Work papers should include detail for all significant items on the report (i.e. share and loan statistics, investment reports, delinquency report)
- Separation of duties will help ensure accuracy. Someone other than the individual preparing the report should review the data prior to submission. The parties involved should sign or initial the report to verify their role.

Because of the significant use of call report data, accuracy is imperative. Therefore, management should ensure that this task is a 'higher level' function. That is, staff responsible for completion of the call report should be 'management' level or qualified to complete and review the data for accuracy and reasonableness.

Please feel free to contact your examiner with any questions regarding the call report.

NEW MISSOURI SECURITIES LAW

Enacted by the Missouri 2003 General Assembly, House Bill 380 became law on August 28, 2003. There appears to be three primary reasons for enacting this legislation.

1. Modernization of the Missouri securities statutes, which had not had a complete revision since 1956.
2. Provide additional protection to shareholders.
3. Provide uniformity to state securities regulation.

This law essentially mirrors the federal statutes outlined in the Gramm Leach Bliley Financial Modernization Act. Missouri credit unions will be affected by this law but the opportunity exists to influence this process by commenting on the current proposed rules that were published for a thirty day comment period in the October 1, 2003 Missouri Register.

The Missouri Securities Commissioner wants to work with credit unions in implementing this law and writing rules and regulations specific to the industry's needs. Credit unions should familiarize themselves with the new statute and participate in formulating enabling rules and regulations.

If your credit union in any way offers securities to your members or participates in networking activities you have a stake in the current proceedings and should consider providing comments on the proposed rules.

FIELD OF MEMBERSHIP UPDATE

Springfield Telephone Employees Credit Union (now **Telcomm Credit Union**) submitted an application to include those persons who reside or work in the 417 telephone Area Code and the 573 (bordered on the north by I-70) telephone Area Code. The Director approved the expansion of **Springfield Telephone Employees Credit Union** to those in the 417 Area Code, but not the 573 Area Code. The decision was published in the November 15, 2000 Missouri Register. On November 30, 2000 the Missouri Bankers Association (MBA) and Century Bank of the Ozarks (CBO) filed an appeal of the decision to the Credit Union Commission. The Commission heard the appeal on March 29, 2001. On May 24, 2001 the Commission upheld the decision of the Director. On August 16, 2001, the decision was released and the Director filed **Springfield Telephone Employees Credit Union's** amended bylaws with the Secretary of State. On September 14, 2001, the MBA and CBO filed a petition for administrative review in Cole County Circuit Court.

On November 19, 2001, a hearing was held before Judge Tom Brown, Division 1, Circuit Court of Cole County. The motion to refer the case to another division of the court was granted and the case was referred to Judge Byron Kinder, Division 2. A motion to dismiss the case for lack of standing was heard on January 3, 2002. On January 29, 2002 the court ruled the plaintiffs lack standing to maintain causes of action set forth in their petition and ordered the plaintiffs' petition be dismissed. On March 11, 2002 the MBA and CBO filed an appeal of the decision in the Western Appellate Court of Appeals. Appellant's briefs were due June 3, 2002 with the respondent's briefs due July 3, 2002. A hearing by the Western Appellate Court was held on October 3, 2002 in Kansas City. On January 14, 2003, the Appellate Court upheld the decision

of Cole County Circuit Court. On January 14, 2003, the MBA and CBO filed motions for a rehearing and transfer to the Missouri Supreme Court. The Appellate Court on March 4, 2003 denied the motions. On April 23, 2003, the Missouri Supreme Court issued an order transferring the case to their jurisdiction. Oral arguments before the Supreme Court were heard on September 10, 2003. Briefs filed with the Supreme Court can be located at <http://www.osca.state.mo.us/sup/index.nsf?OpenDatabase>.

South Community Credit Union submitted an application for those who work or reside in Zip Codes 63109, 63111, 63116, 63123, 63125, 63128, 63129, and Crawford County, Franklin County, Gasconade County and Washington County. **Central Communications Credit Union** submitted an application for those persons who reside or work in the 816 telephone Area Code. The Director approved the applications submitted by **South Community and Central Communications Credit Unions**. These decisions were published in the November 15, 2000 Missouri Register. On November 30, 2000 the MBA and two local banks located in each of the two applicants' field of membership expansion areas filed appeals of the decisions to the Credit Union Commission. The Commission received the record of appeals from all parties on May 24, 2001. On August 9, 2001, the Commission upheld the decisions of the Director. The written decisions were released on January 25, 2002. On February 21, 2002, the MBA and the local banks filed a petition for administrative review in Cole County Circuit Court. Both cases were assigned to Judge Tom Brown, Division 1. On April 17 the cases were reassigned to Judge Byron L. Kinder, Division 2 and a motion was entered to stay the proceedings until the outcome of the Springfield Telephone Employees case was decided. The cases can be followed on the internet at <http://casenet.osca.state.mo.us/casenet/>; the case numbers are 02CV323402 and 02CV323401.

Vantage Credit Union (formerly **Educational Employees Credit Union**) submitted an application for those who live or work in St. Louis County, St. Charles County, Jefferson County, Cape Girardeau County and Franklin County. The application was published in the December 15, 2000 Missouri Register. The Director approved the application and his decision was published in the February 15, 2001 Missouri Register. On March 1, 2001 the MBA and two banks located in the applicant's field of membership expansion area filed an appeal of the decision to the Credit Union Commission. The Commission received the record of appeal of **Educational Employees Credit Union** on October 19, 2001 and established briefing schedules. On March 5, 2002, the Commission dismissed the appeal due to lack of standing. On July 18, 2002 the MBA and the two banks filed a Petition in Mandamus in Cole County Circuit Court. An order by Cole County District Court staying the case was entered on December 2, 2002. The case can be

followed on the internet at <http://casenet.osca.state.mo.us/casenet/>; case number 02CV324797.

City Utilities Credit Union submitted an application for community residents and workers in Greene and Christian Counties. The application was published in the June 1, 2001 Missouri Register. The Director approved the application and his decision was published in the August 1, 2001 Missouri Register. On August 14, 2001 the MBA and a local bank located within the applicant's field of membership expansion area filed an appeal of the decision to the Credit Union Commission. On August 8, 2002 the Commission heard and denied the appeal for lack of standing. The decision was released on December 9, 2002. On January 2, 2003, MBA and the local bank filed a Petition in Mandamus in Cole County Circuit Court. The case can be followed on the internet at <http://casenet.osca.state.mo.us/casenet/>; case number 03CV323001.

First Community Credit Union submitted an application for individuals who reside or work in the counties of Lincoln, Warren, Franklin, Washington, St. Francois, Ste. Genevieve, Pike, Montgomery, Gasconade and Crawford in the state of Missouri and the City of St. Louis. The application was published in the August 1, 2002 Missouri Register. The Director approved the application and his decision was published in the September 16, 2002 Missouri Register. On September 26, 2002 the MBA and a local bank located within the field of membership expansion area filed an appeal of the decision to the Credit Union Commission. The Commission at their October 31, 2002 meeting established the briefing schedule for the appeal. The Commission considered the appeal at their January 15, 2003 meeting heard but took no action. The Commission at their August 28, 2003 meeting established the procedural schedule for hearing the appeal.

Alliance Credit Union submitted an application for those who work or reside in St. Charles County or St. Louis County. The application was published in the November 15, 2002 Missouri Register. The Director approved the application and his decision was published in the January 16, 2003 Missouri Register. On January 30, 2003, the MBA and Allegiant Bank filed an appeal of the Director's decision with the Credit Union Commission. The Commission at their August 28, 2003 meeting established the procedural schedule for hearing the appeal.

St. Louis Postal Credit Union submitted an application for those who live or work in the Zip Codes 63005, 63017, 63042, 63043, 63044, 63126, 63127 and St. Charles County. The application was published in the December 2, 2002 Missouri Register. The director approved the application and his decision was published in the January 16, 2003 Missouri Register. A fifteen calendar period for

appeal must occur before the decision is final. On January 30, 2003, the MBA and Midwest Bank Centre filed an appeal of the Director's decision with the Credit Union Commission. The Commission at their August 28, 2003 meeting established the procedural schedule for hearing the appeal.

United Community Credit Union, an Illinois chartered credit union, submitted an application for those who live or work in the Missouri counties of Lewis, Ralls and Marion. The application was published in the January 2, 2003 Missouri Register. The director approved the application and his decision was published in the February 18, 2003 Missouri Register. On March 4, 2003 the MBA and the Farmers and Merchants Bank and Trust Company filed an appeal of the Director's decision with the Credit Union Commission. The Commission at their August 28, 2003 meeting established the procedural schedule for hearing the appeal.

Aerospace Community Credit Union submitted an application for those who live or work in the remainder of St. Louis City, St. Louis County and St. Charles County that is not currently in the **Aerospace Community Credit Union's** field of membership and those who live or work in Lincoln County. The application was published in the May 1, 2003 Missouri Register. The director approved the application and his decision was published in the July 1, 2003 Missouri Register. On July 14, 2003 the MBA and the First National Bank of St. Louis filed an appeal of the Director's decision with the Credit Union Commission. The Commission at their August 28, 2003 meeting established the procedural schedule for hearing the appeal.

Southeast Telephone Employees Credit Union submitted an application for persons who live or are employed in the Missouri Counties of St. Francois County, Ste. Genevieve County, and Madison County. The application was published in the August 1, 2003 Missouri Register. On August 14, 2003 the MBA and the New Era Bank filed an appeal of the Director's decision with the Credit Union Commission. On August 27, 2003, the application was amended to persons who live or are employed in the Missouri County of St. Francois thereby rendering the appeal moot. The application was published in the October 1, 2003 Missouri Register. A ten business day period for comments must occur before a decision can be made.

Raytown-Lee's Summit Community Credit Union submitted an application for those who live in Zip Codes 64055, 64122, 64138, 64052, 64129, 64034, 64082, 64081, 64063, 64064 and 64086. The application was published in the September 2, 2003 Missouri Register. The director approved the application and his decision will be published in the November 3, 2003 Missouri Register. A fifteen calendar period for appeal after the publication occurs must elapse before the decision is final.

From the Director...

Credit union survey:

The fifth annual credit union survey will be mailed to credit unions later this month. Please take a few moments to complete and return the survey.

In December as customary we will meet with credit union officials to discuss the survey results, interest rate risk, asset diversification, risk focus examination, proposed changes in credit union law and rules along with other current topics. The meeting dates and locations will be included with the survey.


Unrelated business income taxes:

Increasingly in several states unrelated business income taxation (UBIT) is becoming an issue of concern for credit unions. Credit unions in Alabama, Colorado, and Connecticut have been audited by the Internal Revenue Service (IRS) to determine UBIT liability. We know of no credit unions in Missouri being subject to such audits. Temporarily these audits appear to have been suspended. The Division annually completes from the call report and files for all Missouri chartered credit unions the IRS Form 990 "Return of Organization Exempt from Income Tax". Since the information filed is taken from the end of the year call report, credit unions must be diligent and ensure the information is correct. We intend to continue preparing and filing the return as a service to credit unions.

Uncertain is how UBIT applies to credit union operations. Unrelated business income is generally "income from a trade or business ... that is not substantially related to the performance by the organization of its exempt purpose or function except that the organization needs the profits derived from this activity," under the IRS Code. As the IRS explains, despite the fact that an organization is tax exempt, it still may be liable for tax on its unrelated business income. UBIT applies to state chartered credit unions but does not apply to federal credit unions. That is because the IRS Code includes federal credit unions as "federal instrumentalities of the United States," which are not subject to UBIT.

For now, if contacted by an IRS auditor, credit unions are advised to contact the Missouri Credit Union Association immediately. The national credit union associations are working in coordination with the National Association of State Credit Union Supervisors to consider fully all viable political, administrative and litigation strategies to successfully resolve the UBIT issue on behalf of credit unions. Hopefully a remedy may be found.

That is all for this time.

A handwritten signature in blue ink, reading "John P. Smith". The signature is written in a cursive style with a vertical line at the end.

John P. Smith, Director